United States Court of Appeals for the Second Circuit



APPELLANT'S REPLY BRIEF

76-7068

To be argued by
JOSEPH LOTTERMAN

United States Court of Appeals

FOR THE SECOND CIRCUIT

INTERNATIONAL HALLIWELL MINES, LIMITED AND LA SOCIETE D'EXPLOITATION ET DE DEVELOPPEMENT ECONOMIQUE ET NATURAL D'HAITI,

Plaintiffs-Appellants,

-against-

CONTINENTAL COPPER & STEEL INDUSTRIES, INC., MORTIMOR S. GORDON, MIDLANTIC NATIONAL BANK, as Executor of the Estate of Walter H. Knorr, Samuel M. Goldman and Delia Jacobs, as Executors of Estate of Samuel Ungerleider, Marion V. Wheeler, as Executrix of the Estate of Arthur Wheeler and Eleonora Harris, Robert Harris and Joseph Steinhardt, as Executors of the Estate of Harry Harris,

Defendants-Appellees.

REPLY BRIEF OF PLAINTIFFS-APPELLANTS



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The answering brief of the defendants respondents upon this appeal is an extraordinary document, as significant and revelatory for what it does not say as for what it does. Before we proceed with an examination of its contents, it is necessary to underscore the import of the respondents' silence upon vital aspects of the instant case.

The respondents have not even attempted to refute the judicially operative facts upon which the appellants' causes of action have been based or dispute the manner in which those facts have been established by the depositions of Continental's principle officers, directors and employees, to wit, Messrs. Gordon, Knorr, Kennedy, Keller and Castro; the annual reports of Continental and Halliwell; the

minutes of the Board of Directors of each; and the contemporary records and documents produced from the files of Continental and Halliwell.

Not a word can be found in the respondents' brief which endeavors to explain or justify the conduct of Gordon and the other Continental nominees as directors of Halliwell-Sedren; the manner in which they obtained the 1964, 1967 and 1968 agreements from Halliwell for the benefit of Continental; the 1967 general releases which they voted to themselves and their appropriation of the corporate opportunities presented by the Nippon contracts. Not a word is contained in the respondents' brief which even refers to the unconscionable demands of Continental which drove Bell, Knight and Fraser Fell from the Halliwell Board in unavailing protest on April 12, 1967. It is patent, therefore, that the judicially operative facts in this case have been incontrovertibly established by the record and are beyond challenge or dispute.

With these preliminary observations, we turn to a consideration of the several arguments advanced by the respondents in their answering brief.

I.

The principle issues presented upon the trial of the instant case were formulated by Judge Owen on March 14, 1975 in his opinion denying the summary judgment motions of both the plaintiffs and defendants as "questions of fact as to the degree of control and of possible duress exercised over the plaintiff throughout the period relevant to this action."

Notwithstanding the specificity of those issues, the respondents' brief of forty pages literally does not contain

a single word which even purports to deal with the period between June 20, 1961—when the Continental nominees became directors of Halliwell-Sedren and the fiduciary stewards of its future—and July 25, 1967, when they did not stand for re-election. Only one week earlier, at a meeting of the eight man Halliwell Board of July 18, 1967, the three non-Continental Halliwell Board members had been advised by the five Continental members of Halliwell's Board—a complete majority—that Continental was insisting upon Halliwell's payment of its supposed indebtedness to Continental.

In their brief, the respondents are attempting to obliterate those six years of Continental's control and misappropriation of Halliwell's assets and corporate opportunities which brought Halliwell-Sedren to the verge of insolvency. The agreement of March 15, 1968, presented to Halliwell as the only means by which it could extricate itself from its captivity to Continental, was the inexorable culmination of those six years which the respondents now seek to erase.

Those six fateful and disastrous years cannot be expunged from the record. They constitute, in the language of this Court's opinion in *First National Bank of Cincinnati v. Pepper*, 454 F. 2d 626, 631-632, "the factual background of that agreement" (in that case, avoivedly a "compromise agreement") and the "background facts relied upon by the stockholders as proof of duress. . .".

The termination agreement of March 15, 1968, upon which the respondents now exclusively rely as a "settlement agreement", was the inevitable product of the six preceding years of Continental's domination, control and appropriation of Halliwell's properties, assets and resources. The respondent's massive violations of their fiduciary responsibilities to Halliwell and its stockholders

cannot be sheltered by a document which was itself the ultimate consequence of the respondents' fraud and breach of trust.

The Trial Court adopted the respondents' facile misdescription of the March 15, 1968 agreement as a "settlement agreement," in spite of the plaintiffs' insistence in the Court below that it constituted no more than a statement of the price exacted by Continental from Halliwell which was desperately seeking to terminate its calamitous bondage to Continental. (Tr. 5-7; 12-14).

Time and again, throughout the course of their brief, the respondents call upon this Court to restrict its review of this case solely and only to the so-called "settlement agreement". They ask this Court to disregard, as irrelevant, every act committed by Continental and its nominees upon the Halliwell Board prior to July 25, 1967, when the Halliwell nominees failed to stand for re-election.

Thus, at p. 22 of their brief, they assert that the plaintiffs' "description of early dealings among the parties, and to legal arguments over the validity of the 1964 agreements, the 1967 agreements and the 1967 releases when originally executed", as well as the plaintiffs' related language "about fiduciaries releasing themselves from liability, are quite beside the point on the issue of settlement in this Court as well as at the trial".

Again, at page 23 of their brief, we are told that the plaintiffs' objections to "the validity of the 1964 and 1967 contracts and the 1967 releases as void *ab initio*, or their contention that the 1959 contract had become impossible of performance, *has nothing to do* with the validity of the Settlement Agreement".

Finally, at p. 23 of their brief, even the general releases voted by the respondents to themselves in April of 1967—

and prized so highly by them in the court below—have now become irrelevant. Thus, we now read (p. 23): "Although defendants pleaded the releases as a separate affirmative defense (22a-23a; 28a), their validity when executed or susceptability of ratification is *irrelevant* to the scope and effect of the Settlement Agreement."

Settlements do not spring full-grown from the air, as did Athena from the brow of Zeus. They have an antecedent history, background, purpose and meaning. They are not immune, as this Court has explicitly ruled in Pepper, supra, from a judicial inquiry into the "background facts". Even where, as in Pepper, a proceeding then pending by the plaintiffs in the New York State Supreme Court was settled by the plaintiffs in a compromise agreement "negotiated (by the plaintiffs) through their attorney and . . . expressly stated that it was executed by them of their own free will," it was error for the District Court to refuse to review, as "unnecessary", the "factual background of that agreement" and to "rely exclusively upon the terms of the compromise agreement and the pendency of the New York Supreme Court proceeding".

The error committed by the District Court in Pepper was far less egregious than the comparable error committed by the Trial Court under the more aggravated circumstances of the instant case. In Pepper, the settlement agreement was not itself the product and culmination of six years of fiduciary control, abuse and depredation. In Pepper, the plaintiffs had already commenced legal proceedings in the State Supreme Court, the institution of which did not jeopardize their ver tence. In Pepper, the plaintiffs volutarily accepted a compromise agreement negotiated by their counsel with full knowledge of all the facts and executed the document of their own free will.

The respondents' bald attempt to avoid this Court's examination of the manner in which they abused their fiduciary obligations to Halliwell and its thousands of stockholders from and after 1961 is a significant admission of their inability to furnish even a pretense of any justification for conduct which paralleled the worst corporate excesses of the robber baron days. The responsibilities of the respondents cannot be abrogated by the tactical expedient of resigning their Halliwell directorships after six years of debasing their office and voting releases to themselves, and then, procuring a ratification of those releases from their ravaged victims. In the classic words of Judge Cardozo, no Court can tolerate the destruction of the "rule of undivided lovalty" demanded of fiduciaries by "the 'disintegrating erosion' of particular exceptions" or devious subterfuge (Meinhard v. Salmon, 249 N. Y. 458, 464). The respondents' present claims, if sustained, "would make a travesty of the law and of the responsibility of corporate directors" (Rosenfeld v. Fairchild Engine & Airplane Corp., 201 Misc. 616, 620, aff'd. in 279 App. Div. 1086).

II.

We now turn to a consideration, seriatim, of the remaining arguments set forth by the respondents in their brief.

1. It is claimed that the plaintiffs had "an adequate remedy at law" and the "availability of litigation" would suffice to defeat the plaintiffs' cause of action herein. (Respondents' Br., p. 21).

The argument is fatally deficient upon several counts. Even if litigation were available, and its commencement neither futile nor suicidal, the possibility of instituting such a lawsuit would not absolve or exculpate the respondents of their liability herein. In *Pepper*, supra, litigation

was not only available, it was actually existent and the disposition of that litigation was the very subject matter and purpose of the compromise agreement. To the District Court, those facts were dispositive. His ruling, substantially paraphrased by the respondents upon this appeal, was rejected by this Court with the following comments directly applicable to the instant case:

"In granting summary judgment the district court concluded that the parties had entered into a valid compromise agreement, under the terms of which the stockholders were bound to pay the \$75,000 to Pepper. and that it was therefore unnecessary to review the factual background of that agreement. In support of his conclusion that the agreement was valid and voluntarily entered into at arm's length by the stockholders Judge McLean pointed to the fact that it had been negotiated by them through their attorney and that it expressly stated that it was executed by them of their own free will. The stockholders' claim of duress. although not rejected as a matter of law, was treated by him as conclusively refuted by the pendency of proceedings initiated by them in the state court, the court, stating: 'As long as their proceeding in the Supreme Court, New York County, remained undetermined they were not compelled to settle.'

Having reached the foregoing conclusion the district court decided that the background facts relied upon by the stockholders as proof of duress were immaterial. We disagree. In our view the district court was required to give consideration to all of the facts relied upon by the stockholders as evidence of duress rather than rely exclusively upon the terms of the compromise agreement and the pendency of the New York Supreme Court proceeding."

Secondly, had the plaintiffs refused to accept the March, 1968 agreement demanded by Continental, or filed a lawsuit at that time asserting the claims presently before this Court, Continental, would, as Gordon had made brutally plain, have promptly foreclosed its mortgage upon the Sedren mine, which would immediately have deprived Halliwell of its sole asset, as well as the income generated by its production of copper concentrates. The law is ineluctably clear that such an action by Halliwell for the unliquidated damages which it claimed from Continental and its nominees could not possibly have averted a sale by Continental of the mortgaged Sedren mine, without which Halliwell-Sedren were bankrupt, and totally incapable of financing any litigation whatsoever.

In Spano v. Perry, 59 Misc. 2d 1062, in an action to foreclose a mortgage, the defendant filed a counterclaim for fraud. Although the counterclaim stated a cause of action, the defendant was not permitted to stay the foreclosure suit since the damages were unliquidated, and could not be reduced to a liquidated amount until a plenary trial of the fraud issue. Consequently, the Court severed the counterclaim for a subsequent trial, and simultaneously therewith ordered the entry of a judgment of foreclosure and sale. The Court held:

"The counterclaim for fraud appears to state a cause of action. It is noted that the claimed damages, whether based on fraud or breach of warranty, are in the same amount—\$1,850. The defendants assert that they are able and willing to pay the principal amount of the defaulted mortgage but plead that the claimed damages for fraud should be deducted from the amount due. However, any damages for an alleged fraud on the part of the sellers-mortgagees are unliquidated and cannot be reduced to a liquidated claim until a plenary

trial of the fraud issue. The plaintiffs should not be required to await the outcome of such trial before recovering either the mortgage debt or the benefits of a foreclosure.

This court, therefore, severs the asserted counterclaim for fraud and directs that it be tried as a separate issue, either with or without a jury as the defendants may choose, at a subsequent term of this court. The court holds that the plaintiffs are entitled at this time to a judgment of foreclosure and the appointment of a Referee to compute the present amount due to the plaintiffs and to the defendant, Savings Bank of Tompkins County. Thereafter, the mortgaged property may be sold by judicial sale in accordance with the provisions of the Real Property Actions and Proceedings Law."

Semble: City Buying Service Inc. v. 224 Van Wagner Rd. Corp., 44 App. Div. 2d 711.

Obviously, therefore, the respondents' argument that Halliwell possessed an alternative without fear of immediate consequences is totally without merit. Had that procedure been adopted, Halliwell would have been promptly stripped of the Sedren mine and the revenue flowing therefrom; the claim of the debenture holders in the sum of approximately four million dollars would have become due and owing forthwith; and Halliwell would have been totally bankrupt, without any funds to meet its current expenses, let alone its past-due indebtedness, and completely unable to finance any litigation of any kind against Continental.

Finally, the respondents argue: "Nor is there any evidence or explanation why Sedren could not continue the mortgage payments and repudiate the remaining terms of the (March 15, 1968) contract . . ." (Respdts' Br., p. 27).

It is difficult to believe that such an argument has been offered to this Court in good faith. By the express terms and provisions of paragraph 7 of the March 15, 1968 agreement, it was explicitly provided (248A):

"7. In the event that any one or more conditions of this agreement are not fulfilled, either party may on ten clear days written notice to the other cancel this agreement, in which event the Copper Purchase and Concentrates Agreements shall continue in full force and effect."

In short, it was impossible under the terms of that agreement to perform one condition and default upon any other without such a default constituting a breach of the entire agreement, "in which event the Copper Purchase and Concentrates Agreements shall continue in full force and effect." The strait-jacket in which Halliwell-Sedren had been placed by the terms of that agreement could not even be loosened, let alone undone, in the manner suggested by the respondents' present contention that Sedren could have continued the mortgage payments and repudiated the remaining terms of the agreement.

3. It is argued (Respdts' Br., p. 20) that: "There was no attempt to show that financial assistance was unavailable from a source other than Continental".

The argument is patently ludicrous. What bank, insurance company, financial institution or underwriter would conceivably have offered "any financial assistance" to a company so completely dominated and controlled by Continental: (i) whose sole asset, the Sedren mine, was subject to a mortgage to Continental then in default; (ii) whose contract with Continental to supply 80 million

pounds of copper was likewise claimed to be in default; (iii) from whom Continental was demanding huge sums in liquidated damages and unpaid discounts; (iv) which had sustained an operating loss of \$1,674,931 for 1967 and possessed a capital deficit of \$5,422,196 at the close of that year (Pltffs' Ex. 9, 137A); and (v) whose current operating obligations could not be paid?

The very purpose of the termination agreement of March 15, 1968 was to free Halliwell from the iron grasp of Continental and thereby enable it to seek such financial assistance. It was only after the termination agreement was executed in 1968, and Halliwell was free for the very first time since 1961 to deal with others, that, as the respondents themselves concede (Respdts' Br., p. 20), Halliwell was enabled in 1969 to procure new equity capital of \$1,500,000. The fact that the hour was far too late can hardly constitute an excuse for those who had inflicted the grievous wounds upon the corporate body of Halliwell which ultimately proved fatal despite the herculean efforts of Graetz and others.

III.

The respondents' final thesis deals with the Trial Court's inexplicable, obdurate and arbitrary refusal to permit the plaintiffs to call Adolph Graetz as a live witness to the facts and circumstances involved in the instant case. After laboring for more than four printed pages of its brief, with a welter of miscellaneous and contradictory attempts to justify the Trial Court's action, the respondents conclude that "The District Court's exclusion of Graetz's proposed testimony was not erroneous, and in any case not prejudicial to plaintiffs." (p. 32)

The respondents commence their justification of the Trial Court's exclusion of Graetz as a witness for the plaintiffs by repeating the argument heretofore considered "that the proposed testimony of Graetz would have been simply irrelevant to the validity of the Settlement Agreement" (Respdts' Br., p. 30). The fallacies of that contention have been so fully exposed above that no further repetition thereof is required at this point.

Additionally, the respondents contend that, although the circumstances under which the alleged settlement agreement "were presented and executed" and Halliwell's financial and economic condition" at the time "are, of course relevant to the issue of duress" (Respdts' Br., p. 31), the live witness whom the Court permitted the plaintiffs to call, i.e., Robert Bell, "testified in some detail to these matters (Respdts' Br., p. 31), and it was, therefore, incumbent upon the plaintiffs to show that Graetz's testimony would not have merely been cumulative" (Respdts' Br., p. 31).

The foregoing arguments underscore the impossibility of providing any rationale whatsoever for Judge Bonsal's refusal to allow Graetz to testify for the plaintiffs. Bell had resigned as a Halliwell director at the April 12, 1967 meeting of the Halliwell Board, together with Messrs. Knight and Fraser Fell, because they could not stomach the 1967 agreements and general releases which Gordon had demanded. Consequently, he was not present at any subsequent meetings of the Halliwell Board, and more particularly, at any meetings of that Board at which the March 15, 1968 agreement was considered and discussed. Graetz did remain on the Halliwell Board and was fully prepared and qualified, as a matter of personal knowledge, to testify in detail to what actually transpired at those meetings. Why Bell was a proper witness, and Graetz was not, defies understanding.

Moreover, the Trial Court ruled, before Bell took the witness stand, that he would not hear Graetz (Tr. 41-50). Unless he possessed the prescience denied to ordinary mortals, he could not possibly have known what Bell would

testify to* or that the testimony of Graetz might be cumulative in the slightest degree or to any extent.

Finally, Graetz would have testified of his own personal knowledge, as Bell could not, that (1) Gordon had threatened to foreclose Sedren's mortgage unless Halliwell submitted to Continental's demands as set forth in the termination agreement; (2) that Halliwell possessed no viable choice but surrender; (3) that Halliwell's only hope of obtaining any financing from any source for the possible rehabilitation of Halliwell was to free itself, upon any terms, from Continental's tentacles; and finally, (4) that despite every possible effort, Continental's unremitting abuse of Halliwell-Sedren proved fatal.

In short, no matter how the respondents squirm, it is impossible to furnish any credible or comprehensible rationale for the Trial Court's unprecedented exclusion of the plaintiffs' principal live witness which deprived the plaintiffs and their thousands of stockholders of a just recovery for the enormous damage which had been inflicted upon them by these defendants.

IV.

One final consideration, of immense importance, must be noted in connection with the Trial Court's refusal to hear Adolph Graetz. The only live witnesses offered at the trial below were the witnesses tendered by the plaintiffs. Notwithstanding the gravity of the issues before this Court, not a single defendant or any officer or representative of Continental dared to testify, subject himself to cross-examination and submit his credibility and demeanor to the scrutiny of the Trial Court (Tr. 40). In this context, the observations of this Court in Colby v. Klune, 178 Fed. 2d 872, 873-874 (1949) are as applicable to depositions as they are to affidavits:

^{*} No deposition of Robert Bell had ever been taken by either side.

"[A]bsent an unequivocal waiver of a trial on oral testimony-credibility ought not, when witnesses are available, be determined by mere paper affirmations or denials that inherently lack the important element of witness' demeanor. As we observed in Arnstein v. Porter, 2 Cir., 154 F.2d 464, 471: 'It will not do, in such a case, to say that, since the plaintiff, in the manner presented by his affidavits, has offered nothing which discredits the honesty of the defendant, the latter's deposition must be accepted as true.' For the credibility of the persons who here made the affidavits is to be tested when they testify at a trial. Particularly where, as here, the facts are peculiarily in the knowledge of defendants or their witnesses, should the plaintiff have the opportunity to impeach them at a trial; and their demeanor may be the most effective impeachment. Indeed, it has been said that a witness' demeanor is a kind of 'real evidence'; obviously such 'real evidence' cannot be included in affidavits."

CONCLUSION

For all of the reasons set forth in this brief and our main brief, it is respectfully submitted that the judgment appealed from be reversed; that the defendents' defenses of release and settlement be dismissed; and that the case be remanded to the District Court or a Magistrate thereof for a computation of the damages sustained by the plaintiffs.

Respectfully submitted,

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